10 July 2015

Initial review by the institutions of the reform commitments of the Greek authorities sent on 9 July 2015

- The institutions have briefly examined the reform commitments of the Greek authorities set down in a cover letter of Minister Tsakalotos to President Dijsselbloem of 9 July 2015, as well as in a detailed list of prior actions.

- The cover letter makes clear that in the context of a three year ESM programme, there is a need to agree on a comprehensive set of reforms in the areas of fiscal sustainability, financial stability and sustainable growth. It is clear that a new programme will require not only agreeing on detailed prior actions to be enacted in the near term, but also on deliverables over the coming year in the form of structural benchmarks, milestones and quantitative benchmarks to have clarity on the direction of policies over the medium-run. The new documents do provide an indication of forward looking commitments in some policy fields, as some of the suggested prior actions require follow-up implementation action and can thus feed into this medium term strategy. Forward looking actions and some prior actions need to be discussed further as there are a number of areas where greater specificity and clarity need to be provided as part of effort to agree on a new ESM programme.

- The authorities have committed to reach and sustain the primary surplus target of 3.5% of GDP by 2018 in line with the proposals of the institutions that were made public on 28 June 2015. In this context, they have committed to take measures which generate a fiscal yield of 2.5 p.p. of GDP by 2016 from VAT, pension, and subsidy reforms, as discussed previously with the institutions. Given the significant deterioration in macroeconomic and financial conditions, this will be insufficient to reach previously agreed fiscal targets. Additional measures would be needed to reach the targets in the coming years, or the targets would need to be adjusted with financing implications..

- Compared to the previous commitments which the Greek authorities sent to the Eurogroup on 25 June 2015, the authorities have moved closer to the proposal of the institutions released on the web-site of the Commission on 28 June in key fields of a structural nature. For example, the proposals are now aligned in the area of privatisation. The Greek authorities have also accepted some proposals of the institutions in the area of tax administration and compliance, for example to modify legislation on garnishments from the bank accounts and salaries of person/companies who are in arrears to the tax authority. The institutions also welcome the alignment of many of the proposals on pensions.

  In some policy areas, the Greek authorities have requested flexibility on the timetable for phasing out/in measures. This includes the phasing of reforms to eliminate the VAT discounts for islands, to eliminate the solidarity grant on pensions, to eliminate the preferential tax treatment for farmers and to move

towards 100% advance tax payment for individual business tax. A phased approach can smoothen the implementation of reforms, but it should be noted that a number of reforms have already been significantly postponed. It also leads to a lower fiscal yield during the transition period. It is imperative to have clarity on the phase out schedule so that the fiscal impact can be properly quantified. The authorities have indicated a number of compensating measures that could be adopted in case of fiscal shortfalls, including proposals to increase taxes on rental income and to increase the corporate income tax by an additional one percentage point from 26% to 29% as opposed to 28% in the text of the institutions. The proposed measures need to be examined carefully to properly quantify the fiscal yield and to avoid a growth-unfriendly mix. As the proposed changes by the authorities imply a reduction in the fiscal yield of the package, compensating measures are needed and must be adopted up front.

- The latest documents of the Greek authorities contain additional proposals beyond those included in the published text of the institutions. This includes proposals for a variety of actions to tackle tax evasion, to launch additional competitions assessments with the OECD, to work with the OECD on issues such as reform of State Owned Enterprises and avoiding risks in the public procurement, and to have a medium-term programme in the area of justice. An in-depth assessment of these proposals is not possible at this point given the lack of detailed information. The authorities are therefore invited to work closely with the institutions in developing and specifying these policies so as to ensure they are fully aligned with previous programme commitments, and to develop a clearer road map of policy actions over the medium-term. The intention of the Greek authorities to make full use of available technical assistance is welcome and will be a critical factor for success.

- Measures in the financial sector need to be updated and strengthened significantly. The new proposal of the Greek authorities is aligned with the paper released by the institutions as regards measures in the financial sector which deals with the critical issue of Non-Performing Loans. However, the situation in the banking and financial sector has deteriorated markedly as a result of recent developments that led to the imposition of capital controls. This will involve strengthening of banking system capital and the concomitant reinforcement of governance arrangements. The government will engage in coordinated solutions with banks to address the NPL problem and significantly step-up efforts to remove all remaining obstacles to NPL resolution.

- There are a number of areas where there is a need to have a clear common understanding on the content and timing of the authorities' commitment so as to have a clear basis for agreeing an ESM programme. In particular:

    - on <u>pensions</u>, significant risks have materialized after the Council of State ruled pension reforms introduced in 2012 unconstitutional, which could increase annual pension spending very substantially. The authorities have also adopted several pieces of legislation with fiscal impact that have not been offset with the current package of measures. While the authorities have committed to addressing some of these fiscal risks, clear policies and

actions will need to be specified as a matter of priority. Similarly, the authorities will need to specify policies on the implementation of the 2012 reforms (the zero deficit clause).

- on product markets, there needs to be an understanding that the Greek authorities will act on all recommendations under OECD Toolkit–I studies in the coming months as well as open other closed professions (e.g., ferry transportation). Specifically, the authorities should specify a timeline for all actions, including for the implementation of recommendations on Sunday trade, sales periods, over-the-counter pharmaceutical products, pharmacy ownership, milk and bakeries. On the follow-up of the OECD toolkit-II, manufacturing needs to be included in the prior action

- on energy markets, the authorities have suggested that they may put forward an alternative proposal to the privatisation of the electricity transmission network operator (ADMIE). There needs to be a common understanding that the presentation of a proposal alone would not suffice to complete the prior action. There is a need to reach agreement with the institutions that this privatisation must proceed unless replacement measures can be found that have equivalent effect.

- on labour markets, the proposed changes represent a weakening compared to what was proposed by the institutions. There is a need to have a clear commitment that a review should specifically cover existing frameworks of collective dismissals, industrial action and collective bargaining. In addition, the authorities should base any changes upon a consultation process in line with the existing one on the determination of the level of the minimum wage. There is a need to have a common understanding that any changes to the framework for collective bargaining would not take place before end-2015 and? would need to be agreed with the institutions. Any changes should be based on international and European best practices, and should not involve a return to past policy settings which are not compatible with the goals of promoting sustainable and inclusive growth.

The institutions consider that the rapid adoption of legislation is essential to build credibility. We encourage the government to utilize the extensive technical assistance that had been offered in preparing some of the laws. In this regard, the authorities should provide all requested clarifying information and draft legislative proposals to the institutions for their review. Going forward, the government needs to consult and agree with the institutions on draft legislation in relevant areas with adequate time before submitting it for public consultation or to Parliament. The authorities need to fully engage with the institutions to enable comprehensive due diligence to take place.

- On this basis, and under the condition of the understandings and commitments set out above, the proposals of Greek authorities provide a basis for negotiations on a new ESM programme.